No. 18,904

United States Court of Appeals

For the Ninth Circuit

Marine Midland Trust Company, etc., et al.,
Appellants,
vs.
City of North Sacramento, etc.,
Appellee.

City of North Sacramento, a municipal corporation,
Appellant,
vs.
Marine Midland Trust Company, etc., et al.,
Appellee.

On Appeal from the United States District Court for the Northern District of California, Northern Division

OPENING BRIEF OF APPELLANT CITY OF NORTH SACRAMENTO

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OPENING BRIEF OF APPELLANT CITY OF NORTH SACRAMENTO

INTRODUCTION

The District Court granted the motion of the defendant City of North Sacramento (hereinafter "defendant City") to dismiss plaintiffs' action, but defendant City is appealing from that portion of the

Judgment which denies costs to the City. It is also appealing from an Order subsequently made by the District Court on May 22, 1963 (TR 81a) which denied defendant City's motion to amend the Judgment to include an award of costs, and for leave to file a counterclaim against plaintiffs for certain costs, damages and expenses resulting to defendant City from the bringing of the action. This Brief is defendant City's Opening Brief on its appeal from the "without costs" portion of the Judgment of Dismissal from the Order which denied its post-judgment motions.

JURISDICTION

Plaintiffs' complaint alleged diversity of citizenship (TR 1 and 2), but defendant City urged in the District Court that diversity was absent because plaintiffs had failed to join an indispensable party, to-wit, Citizens Utilities Company of California, a California corporation, whose interests would require its alignment with plaintiffs, thus putting California citizens on both sides of the litigation. Accordingly, defendant City sets forth no grounds here for jurisdiction in the District Court to support plaintiffs' action.

The District Court had jurisdiction however to grant the relief sought by defendant City. Jurisdiction to award to defendant City its costs is granted by 28 U.S.C. § 1919 and Rule 54(d) of the Federal Rules of Civil Procedure. It had diversity jurisdic-

tion to hear defendant City's counterclaim against the plaintiffs, as that did not involve any absent parties, and the procedural sanction therefor is contained in Rule 13(e) and 15(d) of the Federal Rules of Civil Procedure.

This Court of Appeals has jurisdiction to review the District Court's Judgment denying costs to defendant City and its denial of defendant City's motions to file a counterclaim and to amend the judgment re costs, under 28 U.S.C. 1291.

STATEMENT OF THE CASE

Plaintiffs brought this action in the District Court to set aside the defendant City's prior condemnation of a privately owned water system serving the City of North Sacramento and its inhabitants (Complaint, TR 1-25). The condemnation proceeding had been instituted by the defendant City on December 3, 1956 (TR 6, line 4), and Interlocutory Judgment of Condemnation was rendered by the Superior Court of the State of California, in and for the County of Sacramento, on November 5, 1959 (TR 6, lines 26-28). The parties to the State Court condemnation action were the defendant City (as plaintiff) and Citizens Utilities Company of California, a California corporation, the owner of the water system (as defendant).

The gist of the plaintiffs' action in the District Court was that payment of the condemnation award in the State Court by defendant City was void and

ineffective because the money used for payment was obtained from a bond sale which was alleged to be unlawful, improper and illegal (TR 20, par. No. 57) in several respects. The principal charge of the complaint was that the City delivered a no-litigation certificate to the bond purchaser during the period when the condemnee could still take an appeal to the United States Supreme Court on a question relating to increase in value of the water system during the period of the condemnation proceeding (TR 6-14).

Plaintiffs' alleged standing to complain of the legality of the defendant City's payment of the condemnation award was grounded upon the fact that, pursuant to an Indenture of Mortgage and Deed of Trust between it and the parent corporation of Citizens Utilities Company of California, the condemnee in the State Court proceeding, it had the right to receive awards paid for the condemnation of subsidiary-owned property.

The defendant City and the co-defendants, the Mayor, Treasurer and City Clerk, filed a motion to dismiss on several grounds, and this motion, after considerable briefing by both sides, was granted by the District Court on April 16, 1963 (TR 47-54). The formal Judgment of Dismissal was entered on April 25, 1963 (TR 57).

Within ten days after the entry of the formal Judgment of Dismissal, the defendant City made a motion to file a counterclaim under Rules 13(e) and 15(d), for recovery of its costs, damages and expenses

resulting from the bringing of the action, pursuant to Section 526b of the California Code of Civil Procedure; it also filed a companion motion to amend the Judgment to allow the City its costs under Rule 59(e). The co-defendant City officers did not join in these motions as all such costs, damages and expenses had been borne by the defendant City. Plaintiffs filed no points or authorities in opposition to either of defendant City's motions, and on the day set for hearing of the motions, the Court took them under submission without oral argument from either party. It then denied both motions on May 22, 1963.

The questions involved upon this appeal taken by the defendant City are as follows:

a. Whether the District Court erred in denying defendant City's motion to file a counterclaim to permit recovery under C.C.P. 526b; and

b. Whether the District Court committed an abuse of discretion in denying the defendant City its costs.

SPECIFICATION OF ERRORS RELIED UPON

1. The District Court abused its discretion in denying defendant City's motion to file a counterclaim to recover, under C.C.P. 526b, the costs, damages and expenses resulting to it from the bringing of the action by plaintiffs.

2. The District Court abused its discretion in not awarding the defendant City its costs as "the prevailing party" under Rule 54(d).

ARGUMENT OF THE CASE

1. THE DISTRICT COURT ABUSED ITS DISCRETION IN DENYING DEFENDANT CITY'S MOTION TO FILE A COUNTERCLAIM TO RECOVER THE COSTS, DAMAGES AND EXPENSES RESULTING TO IT FROM THE BRINGING OF THE ACTION BY PLAINTIFFS, BECAUSE THIS WAS A DIVERSITY CASE AND SUCH A RECOVERY WAS CLEARLY SANCTIONED BY CALIFORNIA LAW (C.C.P. 526b), THE CLAIM COULD BEST BE DETERMINED AND ALLOWED BY THIS COURT WHICH WAS FAMILIAR WITH THE CASE AND HAD JURISDICTION OVER THE PLAINTIFFS, AND THE PLAINTIFFS MADE NO FORMAL OPPOSITION TO THE FILING OF THE COUNTERCLAIM.

Section 526b of the California Code of Civil Procedure provides as follows:

> "Every person or corporation bringing, instigating, exciting or abetting, any suit to obtain an injunction, restraining or enjoining the issuance, sale, offering for sale, or delivery, of bonds, or other securities, or the expenditure of the proceeds of the sale of such bonds or other securities, of any city, city and county, town, county, or other district organized under the laws of this State, or any other political subdivision of this State, proposed to be issued, sold, offered for sale or delivered by such city, city and county, town, county, district or other political subdivision, for the purpose of acquiring, constructing, completing, improving or extending water works, electric works, gas works or other public utility works or property, shall, if the injunction sought is finally denied, and if such person or corporation owns, controls, or is operating or interested in, a public utility business of the same nature as that for which such bonds or other securities are proposed to be issued, sold, offered

> for sale, or delivered, be liable to the defendant for all costs, damages and necessary expenses resulting to such defendant by reason of the filing of such suit."

A brief analysis will show that this statute was applicable to the action brought by these plaintiffs, and that upon its dismissal by the District Court, defendant City was entitled to recover from the plaintiffs all of the costs, damages and necessary expenses resulting to it by reason of the filing of such suit.

The gist of plaintiffs' complaint was that the defendant City was "guilty of unlawfully, improperly and illegally issuing and selling its Water Revenue Bonds" (TR 20, par. No. 57), and the plaintiffs sought judgment

> "Declaring, adjudging and decreeing . . . that the deposit in the sum of $2,206,000 made by defendants, with the Clerk of the Superior Court, in and for the County of Sacramento, is . . . disqualified to serve as an effective payment and as a predicate for a transfer of title and possession of the said water system to defendant City;" (TR 23, par. 1(a) of prayer).

The action, while not in form seeking to enjoin the expenditure of the bond proceeds for the acquisition of the water system, sought to reach the same end by asking for a declaratory judgment nullifying the City's payment for the water system. Such a judgment would of course fully prevent the City from paying for the water system with the bond proceeds. In result, effect and substance, the action sought to

restrain or enjoin the expenditure of the proceeds of the City's bonds for the purpose of acquiring the water works or system.

The judgment dismissing the action operated as a final denial of the "injunction sought". Finally, the plaintiffs are persons who own, control, operate or are interested in a public utility business of the same nature as the water works being acquired by defendant City. The complaint alleges that Citizens Utilities Company, parent corporation of Citizens Utilities Company of California, was engaged directly and indirectly through subsidiary corporations, in the ownership and operation of various public utility systems in ten of the states of the United States (TR 3, lines 2-4), and that Citizens Utilities Company had pledged all of its issued and outstanding stock with the plaintiffs as collateral security for bonds issued by Citizens (TR 3, line 32, and TR 4, lines 1 and 2). As the City pointed out to the District Court in seeking to file its counterclaim, Citizens had additionally conveyed via the Indenture of Mortgage and Deed of Trust to plaintiffs (TR 3, par. No. 12), several other water systems owned by it in California and other states as security for its loans.

Thus the defendant City, in making its companion motions to amend the judgment and for leave to file a counterclaim, was invoking an absolute substantive right of recovery given to it by State law. C.C.P. 526b entitled it to recovery of its attorney's fees, *S.M.U.D. v. P.G.&E.,* 20 C.2d 684, which are not normally recoverable under California law (C.C.P.

1021), all costs necessarily incurred in the litigation, plus any damages resulting from the filing of the suit. These are substantial rights, giving the City a right of recovery which goes way beyond that which the State normally affords to successful litigants.

There is a clear, unmistakable policy of the State of California embodied in the statute. As a practical matter, cities and public agencies can finance the acquisition and development of utilities to serve their inhabitants only through the sale of long-term bonds. Section 526b is obviously designed to inhibit adverse interests from rupturing this financing ability by groundless attacks on the sale of the bonds. Even though utility-inspired litigation attacking the bonds or their sale may ultimately be unsuccessful, serious harm to the City results. Investors either become unwilling to purchase the City's bonds or are willing to do so only at a discount and at burdensome interest rates.

> "It (the private utility) would be especially tempted to prosecute such litigation, and the Legislature in order to protect the public agency in engaging in a pursuit which it deemed necessary to the public welfare, might reasonably have required, as it did, that a private utility with such a probable motive should reimburse the public treasuries for expenses incurred in unjustifiable litigation prosecuted by the utility." *Sacramento M.U.D. v. P.G.&E. Co.*, 20 C.2d 684, 694.

This is a diversity case. Plaintiffs based the jurisdiction of the federal Court upon their allegations

that they were citizens of New York and Connecticut respectively, that defendants were citizens of California, and that the matter in controversy exceeded $10,000 (TR 1 and 2, par. 1-7 of complaint). The District Court exercised its diversity jurisdiction and disposed of the case as a California Court (TR 53).

Particularly in view of the clear State policy underlying C.C.P. 526b, the District Court should have, following the dismissal of plaintiffs' action, permitted defendant City to file its counterclaim for its costs, damages and expenses, and it should also have granted the City's motion to amend the judgment to award the defendant City its "costs". This absolute and substantive right of recovery must be given effect by the federal Court in a diversity case under the Rules of Decision Act, now contained in 28 U.S.C. 1652:

> "The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply."

The federal Court cannot pick and choose from among state laws in a diversity case; it must take and apply the state law as it finds it.

> "In essence, the intent of that decision (Erie R. Co. v. Tompkins) was to insure that, in all cases where a federal court is exercising jurisdiction solely because of the diversity of citizenship of the parties, the outcome of the litigation in the federal court should be substantially the same,

> so far as legal rules determine the outcome of a litigation, as it would be if tried in a State court. The nub of the policy that underlies Erie R. Co. v. Tompkins is that for the same transaction the accident of a suit by a non-resident litigant in a federal court a block away should not lead to a substantially different result." *Guaranty Trust Co. v. York,* 326 U.S. 99, at 109, 89 L.ed. 2079, at 2086.

Again and again the United States Supreme Court has made it clear that the federal Courts must accept and apply state statutes in diversity cases. Addressing itself particularly to a Nebraska attorneys fee statute in *Sioux County v. National Surety Co.* (1928), 276 U.S. 238, 72 L.ed. 547, the Court said:

> "Disregarding mere matters of form it is clear that it is the policy of the state to allow plaintiffs to recover an attorney's fee in certain cases, and it has made that policy effective by making the allowance of the fee mandatory on its courts in those cases. It would be at least anomalous if this policy could be thwarted and the right so plainly given destroyed by removal of the cause to the federal courts." (276 U.S., at 243).

The Supreme Court reached the same conclusion on an attorney's fee statute and directed that it be applied in the diversity action entitled *Cohen v. Beneficial Industrial Loan Corp.* (1948), 337 U.S. 541, 93 L.ed. 1528, 69 S.Ct. 1221.

It is plain that the District Court has discretion in permitting the filing of a counterclaim under Rule 13(e) of the Federal Rules of Civil Procedure. How-

ever, every factor present favored the filing of the counterclaim. The defendant City had an absolute right to the recovery sought under State law. The District Court was familiar with plaintiffs' suit and the efforts required of defendant City to defend against it. Plaintiffs being citizens of New York and Connecticut respectively (TR 1), the District Court's denial compels defendant City to seek its recovery under C.C.P. 526b against these plaintiffs at their domicile in New York and/or Connecticut, which may in practical effect defeat its recovery entirely. There is a good possibility that those jurisdictions would not permit recovery under the California statute, particularly if such a cause of action did not exist in their jurisdiction.

> "The purpose of Rule 13(e) is to provide a means for complete litigation in one action of all claims that parties may have with respect to each other and thus avoid a multiplicity of actions. 3 Moore's Federal Practice (1948) 2 Ed., Para. 1332, p. 85 et seq." *Cold Metal Products Co. v. Crucible Steel Co.* (D. N.J. 1954), 126 F. Supp. 546.

See also *Kerotest Mfg. Co. v. C-O-Two Co.*, 342 U.S. 180, 96 L.ed. 200, 72 S.Ct. 219, sanctioning "conservation of judicial resources and comprehensive disposition of litigation", and affirming the decision of the Court of Appeals for the Third Circuit which declared:

> "Why should there be two litigations where one will suffice? We can find no adequate reason." (page 183)

Finally, the plaintiffs filed no reasons or authorities in opposition to defendant City's motion as required by Rule 12(b) of the Rules of Practice for the District Court, nor made an oral argument in opposition to it. In view of all of these circumstances, it was a clear abuse of discretion for the District Court to deny defendant City leave to file its counterclaim.

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2. THE DISTRICT COURT ABUSED ITS DISCRETION IN NOT ALLOWING DEFENDANT CITY ITS COSTS UNDER F.R.C.P. RULE NO. 54(d), INSOFAR AS DEFENDANT CITY WAS CLEARLY THE PREVAILING PARTY AND NO REASON WAS PRESENT FOR MAKING IT PAY ITS OWN COSTS. IN ADDITION, C.C.P. 526b AND THE ABSENCE OF FORMAL OPPOSITION TO THE CITY'S MOTION RE COSTS MADE THEIR ALLOWANCE TO DEFENDANT CITY MANDATORY.

Quite aside from defendant City's rights under C.C.P. 526b, it should have been awarded its costs under the Federal Rules of Civil Procedure. The meaning of Rule 54(d) relative to awarding of costs is clear.

> "Except when express provision therefor is made either in a statute of the United States or in these rules, costs shall be allowed as of course to the prevailing party unless the court otherwise directs. . . ."

In this case defendant City was clearly the prevailing party. There is no federal statute or Rule on costs specially applicable. Costs should therefore have been awarded to defendant City. Admittedly the District Court may, in its discretion, deny costs to the prevailing party, but there must be *some reason* for doing so. None was present in this case. The Court's

Memorandum and Order (TR 47) concludes that the motion to dismiss the action should be granted, but gives no reason why defendant City should bear its own costs. The formal Judgment of Dismissal "without costs" (TR 57) gives no reason. The Order made on May 22, 1963 (TR 81a) denying defendant's motions relative to costs gives no reason. There was in fact no reason present.

The District Court's discretion to deny costs to the prevailing party cannot mean that it may grant or deny them however it is so inclined. Reason must be present for denying them to the prevailing party. The underlying principle was well stated in *Chicago Sugar Co. v. American Sugar Co.* (7th Cir. 1949), 176 F.2d 1, at page 11:

> ". . . the denial of costs to the prevailing party or the assessment of partial costs against him is in the nature of a penalty for some defection on his part in the course of the litigation as, for example, by calling unnecessary witnesses, bringing in unnecessary issues or otherwise encumbering the record, or by delaying in raising objection fatal to the plaintiff's case. . . . in the absence of some showing of bad faith or the deliberate adoption of a course of business dealings calculated to render litigation pertaining thereto unnecessarily prolix and expensive, the penalty of denial or apportionment of costs under Rule 54(d) should be imposed only for acts or omissions on the part of the prevailing party in the actual course of the litigation, except that where it is clear that the action was brought in good faith, involving issues as to which the law

is in doubt, the court may in its discretion require each party to bear its own costs although the decision is adverse to plaintiff."

In view of the foregoing, in view of the California policy outlined in C.C.P. 526b, and in view of the plaintiffs' failure to file or present any reasons or authorities in opposition to defendant City's motion to amend the Judgment relative to costs, it was clearly an abuse of discretion for the District Court to deny this motion also.

Wherefore, defendant City prays that this Honorable Court order the District Court to amend its Judgment of Dismissal made and entered on April 26, 1963, by striking therefrom "without costs", and inserting in lieu thereof the following: "all costs in this proceeding to be taxed upon the plaintiffs"; and further, to make its order permitting defendant City to file its counterclaim against the plaintiffs, in substantially the form attached to its motion therefor dated May 6, 1963.

Dated, December 4, 1963.

Respectfully submitted,

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Certificate of Counsel

I certify that, in connection with the preparation of this Brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing Brief is in full compliance with those rules.

Daniel F. Gallery